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ABSTRACT

The paper offers guidelines for estate planning, defined as the art of arranging one's affairs to best care for loved ones while, at the same time, minimizing transfer costs. An understanding of the basics of estate planning is essential if one is to provide for the future of a severely handicapped child. Definitions are given for federal estate tax, gross estate, and taxable estate; and procedures for calculating gift taxes are reviewed. Wills are considered in terms of legal aspects and estate administration, methods for execution, and suggestions for parents of a retarded child. Aspects of trusts are examined; topics include elements of a trust, types of trusts, and powers and duties of trustees. Life insurance is another useful estate planning device that is addressed. Areas mentioned are types of policies, settlement options, tax considerations, and practical uses. Annuities are covered in a final section. Particular emphasis is given to annuities under qualified retirement plans. (SW)

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PLANNING A MORE SECURE FUTURE FOR SEVERELY HANDICAPPED CITIZENS-- ESTATE AND GIFT TAXATION, WILLS, TRUSTS, LIFE INSURANCE AND ANNUITIES

by

Don L. Frugé, J. Larry Tyler, and James W. Mann

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Planning a More Secure Future for Severely Handicapped Citizens-- Estate and Gift Taxation, Wills, Trusts, Life Insurance and Annuities

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Don L. Frugè, J. Larry Tyler, and James W. Mann*

In order to plan a more secure future for a severely handicapped child, one must understand the basics of estate planning. Estate planning is simply the art of arranging one's affairs to best care for their loved ones while at the same time minimizing transfer costs. It often involves planning to create an estate where insufficient assets presently exist. This paper will review the basics of estate and gift taxation, wills, trusts, life insurance, and annuities, which are the basic tools of estate planning.

Estate and Gift Taxation

What is the federal estate tax and how is it calculated? The estate tax is a tax on the privilege of transferring property at death levied against the estate. The estate, for tax purposes, is not synonymous with the probate estate. Accordingly, the estate tax may be assessed not only on property owned by the decedent at the time of death and passing by will or intestacy, but also on property passing by other means, such as joint ownership and contractual agreements like life insurance.

Assets includable in a decedent's estate, for estate tax purposes, are valued at "fair market value" on the date of decedent's death, or if the executor elects, on the alternate valuation date, six months after the decedent's death. Fair market value is defined as the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

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The value of all the decedent's assets includable in his estate equals the gross estate. This total is reduced by the allowable deductions to yield the adjusted gross estate. From this latter amount is substracted the marital deduction and charitable bequests to reach the taxable estate on which estate tax is imposed. The rate of tax currently ranges from 18 percent on the first 10,000 dollars to 55 percent on an estate in excess of three million dollars. This maximum rate, however, will be lowered by five percent in 1985 making the maximum rate 50 percent on amounts in excess of two and one-half million dollars.

Gross Estate

The gross estate includes all the property in which the decedent has an interest at the time of death, whether real or personal property, tangible or intangible, wherever it is located. In addition, other kinds of property are includable in the decedent's gross estate for estate tax purposes, some of which may not be owned by the decedent at his death. For estate tax purposes, the estate includes the following additional categories of properties:

(1) The value of gifts made within three years of the decedent's death but only if such properties are includable under categories (2), (5), and (6) below or would have been includable under such categories if the property had been retained by the decedent until his death.

(2) The value of property transferred by the decedent in which certain legal or beneficial interests were retained. Transfers which fall in this category are those in which the decedent retained a life interest, power over income from the property, a reversionary interest, power to revoke, alter or terminate the transfer, or power to change the beneficiaries.

(3) The value of certain annuities received by a surviving beneficiary.

(4) The value of jointly held property, such as checking accounts, savings accounts, and real estate; however, certain exceptions provide for inclusion of only a portion of the value of joint property such as joint property held by husband and wife and other joint interests in which the surviving co-tenant establishes a separate contribution to the purchase of the property. Beginning in 1982, one-half of the value of property held jointly between spouses will be includable in the estate of the first spouse to die.

(5) The value of the property over which the decedent owned a general power of appointment.

(6) The value of life insurance proceeds received by the estate on the life of the decedent or received by any beneficiary on the life of the decedent to which the decedent at the time of death retained any incident of ownership.

Taxable Estate

Certain deductions are allowed against the gross estate in order to determine the decedent's taxable estate. These deductions include the following:

(1) The value of expenses and debts owed by the estate. This category includes funeral expenses and other similar charges such as plot and tombstone costs; administrative expenses such as attorney fees, executor commissions, accounting and appraisal fees, and other miscellaneous expenses; and court costs. Personal obligations of the decedent that are enforceable against his estate, such as accrued interest expenses and unpaid debts, mortgages, and taxes are also deducted; however, income taxes due on income earned after the decedent's death are not deductible.

(2) The value of losses incurred while the decedent's estate is being administered and not covered by insurance.

(3) The value of transfers made for certain public, charitable, and religious uses.

(4) The value of property that passes to the decedent's surviving spouse. Since 1982, this deduction is unlimited in amount.

By substracting these deductions from the gross estate, the taxable estate is determined. The taxable estate is increased by the decedent's adjusted taxable gifts (gifts made after December 31, 1976) to reach the sum on which the gross estate tax is computed. This gross estate tax payable is reduced by any gift tax paid on gifts made after December 31, 1976, and may be further offset by the following tax credits available to estates:

(1) The unified tax credit. For 1984 the unified tax credit is $96,300. This credit permits up to $325,000 in property to pass free of federal estate or gift taxes. It can be applied against either gift or estate tax liability. The unified credit, and the equivalent amount of property which can escape federal estate and gift taxes, will be increasing over the next three years in accordance with the following schedule:

YEAR	UNIFIED TAX CREDIT	EQUIVALENT EXEMPTION
1984	$96,300	$325,000
1985	$121,800	$400,000
1986	$155,800	$500,000
1987	$192,800	$600,000

(2) State death tax credit. This credit equals state death taxes actually paid, but not in excess of certain limits imposed by statute.

(3) Gift tax credit. This credit equals the amount of taxes paid on certain property which the decedent transferred during his life if that property was included in his gross estate.

(4) Federal estate tax credit. This credit is available for a portion of federal estate taxes previously paid by another estate on property currently included in the decedent's estate. The property transferred must have been received by the current estate from a decedent who died within 10 years prior or two years after the date of death of the current decedent.

(5) Foreign death taxes.

The following computation illustrates how estate taxes are computed on a gross estate of $800,000, with deductible expenses of $100,000, in which the decedent devised one-half of his adjusted gross estate to his surviving spouse and $50,000 to charity. Assume no gifts were made during the decedents lifetime and the decedent died in 1984.

Estate Tax Computation:

Gross Estate			$800,000
Less:	Funeral Expenses	$10,000	
	Administrative Expenses	30,000	
	Losses	2,000	
	Mortgages and other Debts	58,000	100,000
Adjusted Gross Estate			$700,000
Less:	Marital Deduction	350,000	
	Charitable Contributions	50,000	400,000
Taxable Estate			$300,000
Adjusted Taxable Gifts			-0-
Sum on which Federal estate tax is computed			$300,000
Gross Estate Tax			87,800
Less:	United Credit	96,300	
	State Debt Taxes (assume $3,600 actually paid)	3,600	99,900
Federal Estate Tax Payable			-0-

The unified tax rates are applicable to both estate and gift tax calculations. This unified tax system is a progressive one, much like the present federal income tax system.

Estate Tax Return Filing Requirements

Within nine months after the decedent's death, the decedent's estate tax return (Internal Revenue Service Form 706) must be filed. But an estate tax return is not always required. For a decedent dying in 1984 an estate tax return is due only if the decedent's gross estate exceeds $325,000. For decedents dying in later years, the gross estate must exceed the exemption equivalent of the unified tax credit, as previously set forth. Thus, estates of decedents dying in 1987 and thereafter, which equal $600,000 or less, will not be required to file a return.

Calculating Gift Taxes

For gift tax purposes, a gift has been made when property is transferred outright, in trust, or otherwise for less than adequate consideration. The gift can be a direct or indirect transfer of real or personal, tangible or intangible property. The objective facts of the transfer and the circumstances under which it is made will determine whether a gift has been made, rather than the subjective motives or intent of the donor.

Every donor may give property having a value of as much as $10,000 annually per donee free of federal gift tax; however, this exclusion is available only for a gift of a present interest in property. That is, the property must be enjoyable immediately. Accordingly, a father, who has three children, may transfer $10,000 to each child annually, without liability for gift taxes due to the annual $10,000 per donee exclusion. If annual gifts do not exceed these exclusions, no gift tax return is required.

For gifts made between spouses, the donor spouse obtains the benefits of the gift tax marital deduction. The amount of any such gift qualifies fully for the marital deduction and no gift tax return is required. The only requirement for receiving this gift tax marital deduction is that the donor and the donee must be married at the time of the gift.

Another gift tax rule, pertaining solely to spouses, permits a spouse to "split" any gift made to a donee with the donor spouse so that the gift is treated as being given one-half by each. To qualify, the gift must be made to someone other than the donor's spouse. For example, husband transfers real estate worth $40,000.00 to his daughter and son-in-law. His wife consents to split the gift so that each spouse is treated as having made a gift of $20,000 to the daughter and son-in-law ($10,000 to the daughter and $10,000 to the son-in-law). Since husband and wife each get an exclusion of $10,000 per donee, each is entitled to $20,000 in exclusions (two donees at $10,000 each). Thus, no gift tax is due on the transfer.

To determine the gift tax payable on a current taxable transfer, the value of all prior lifetime taxable gifts is added to the current taxable gift. A tentative gift tax is computed on this sum. From this tentative tax is deducted the unused unified tax credit and gift taxes on prior gifts.

For example, assume a donor makes his first gift of $160,000 to his son in 1984. The tax computation is made as follows:

Gift Tax Computation:

Gross Amount of Gift	$160,000
Less: $10,000 per donee exclusion	10,000
Gift Subject to Gift Tax	$150,000
Gross Gift Tax Payable	38,800
Less: Unified Tax Credit (Credit of $96,300 available in 1984)	38,800
Gift Taxes Payable	-0-

Gift Tax Return Filing Requirements

Gift tax returns (Internal Revenue Service Form 709) are filed on an annual basis. Generally, all required returns are due on the 15th day of April after the calendar year in which the gift was made.

Income Taxation of Gifts

The donee does not include the value of property received by gift or inheritance in gross income for income tax purposes. This exclusion from gross income does not extend to income generated by the gift or inherited property, and such income will be subject to income taxation upon receipt.

Basis in Inherited or Gift Property

When property is transferred from the decedent's estate, the heir takes as his basis in that property its fair market value on the date of the decedent's death or the fair market value on the alternate valuation date, if elected by the executor. Accordingly, if the fair market value of the property on the decedent's death exceeds his basis in the property, that potential gain escapes federal income taxation. This basis acquired by the heir is often referred to as a "stepped-up basis."

To illustrate the stepped-up basis rule, assume a decedent purchased 100 shares of stock on June 1, 1950, at $10 per share, for a total cost of $1,000. On December 1, 1983, the decedent died, when the value of the stock had appreciated to $50 per share. The decedent's estate tax return includes the stock at the fair market value of $5,000, which would become the heir's basis in the stock. If the heir sells the stock five years later for $100 per share, only the appreciation accruing after the date of the decedent's death will be subject to taxation for income tax purposes.

Sales price 12/1/86	$10,000
Basis (fair market value 12/1/83)	5,000
Gains subject to income tax	$ 5,000

Where property is transferred by gift, however, the donee does not receive a stepped-up basis. Generally, the donee's basis in property received by gift is the same as the donor's basis; however, the donee's basis in property received as a gift may be increased by the amount of gift tax attributable to any appreciation in the gift property.

Wills and Administration of Estates

Probate of a will and administration of an estate are the legal processes by which an estate is settled and distributed to the heirs. During the period of administration, the deceased person's assets are collected, debts and taxes are paid, and any remaining assets are distributed in accordance with his will. Essential to this process is a carefully drafted will.

A. A will permits the maker, known as the testator, to designate the persons and/or institutions to whom he wants his property to pass at his death. If a person dies without a will, the law of intestate succession determines who receives the deceased person's property. Under the laws of intestate succession in Mississippi, a deceased person's children and spouse take the person's property in equal shares. Each state has similar laws. If the deceased person has no spouse or children, the law designates which relatives will inherit his property. Such a distribution may prove unsound. For example, the probate estate of a husband who dies without a will and is survived by a wife and three children will be divided among the wife and children in four equal shares. This result may cause the husband's estate to be burdened with unnecessary estate taxes due to the failure of the husband to fully utilize the estate tax marital deduction. Further, property may pass directly to minors who are not legally able to deal with the property, requiring the appointment of a guardian by the court. These adverse consequences could be avoided by the execution of a will, leaving the spouse sufficient property to obtain the maximum marital deduction for the estate and creating trusts to manage the property of the minors or other persons not capable of properly managing their estate.

B. The testator may waive certain probate and administration costs in a properly-executed will. State law requires the executor or administrator (the representative of the estate) to post a bond with the court equal to the value of the decedent's estate, not including realty. He must also file an inventory

and appraisal of certain assets of the estate. By means of a will, a testator may waive the legal requirements of inventory, appraisal, and bond. Unless these requirements are waived, unnecessary court costs will be generated by the probate procedure, thereby reducing the assets passing to the heirs.

C. The testator may select his fiduciary representatives. A testator may name his executor, who is the person or institution legally authorized to carry out the provisions of his will. The Executor will receive, for his services, a fee of approximately 1-7% of the value of the estate assets handled by him, as determined by the court. If a decedent fails to name an executor, the court will appoint someone to serve. By means of a will, a testator can also name a trustee to manage property passing to minors or other persons not capable of managing the property and a guardian for minor children or children under some other legal disability.

D. Certain tax advantages are available by means of a properly drawn will. The maximum tax savings of the marital deduction may be lost without a properly drafted will. For example, the estate of a husband, survived by a wife and three children, may pay unnecessary estate taxes if the husband has no will. The wife receives only a one-fourth interest in the probate estate; whereas, the entire estate could have passed to the surviving spouse free of federal estate tax. Finally, an estate may lose the benefit of the estate tax marital deduction entirely if no will has been executed. If a husband and wife die simultaneously, state law prevents either spouse from inheriting property from the other; therefore, neither estate obtains a marital deduction. The spouse having the larger estate may provide in his will that he will be deemed to have predeceased the other spouse in case of a common disaster, thereby allowing a portion of his estate to qualify for the marital deduction.

Execution of a Will

Of the three types of wills, the most common is an attested will. In Mississippi, an attested will must be signed by the testator and two witnesses who sign in the testator's presence. Some states require three witnesses. A holographic will must be entirely handwritten by the testator and signed by the testator at the bottom of the instrument. No witnesses are required. A nuncupative will is made orally but is of very limited use. To make a valid nuncupative will, the testator must believe he is dying, lack the ability and time to reduce the will to writing, and intend that his words constitute his will.

In Mississippi, a will can be made by any person who is of sound and disposing mind and at least 18 years of age. A person is deemed to be of sound and disposing mind if he understands the significance of a will, knows the people who are to inherit his property and their relationship to him, and is capable of determining how he desires to dispose of his property. The testator need only be of sound and disposing mind at the time he takes steps to execute a will. His lack of mental capacity before or after execution of the will does not raise a presumption that he is mentally incapable at the time the will is executed.

Courts in other states have held that a retarded person may be of sound and disposing mind, possessing the capacity to execute a valid will, even though a guardian has been appointed for him. Mental incompetency, thus, is not determinative of legal soundness for execution of a will.

A will is not valid if the will was executed while the testator was under the undue influence of another person. Undue influence will be presumed if suspicious circumstances surround the making of the will and if the testator has such confidence in a person or such a relationship with a person that the person exerts significant influence over the testator. Suspicious circumstances include cases in which the testator has a mental infirmity or a beneficiary is actively involved in the preparation or execution of the will. Evident from the definition of undue influence is the need for the exercise of care by anyone assisting a retarded person in the execution of a will. Due to the difficult questions concerning the capacity of a retarded person and the possibility of undue influence, attorneys may be reluctant to prepare a will for a retarded person.

A will clearly should be executed by any person, especially a parent, who is concerned about the future well-being of a retarded person. A will allows a parent to appoint a guardian for a retarded child even if the child is an adult, and to create a trust for the retarded person's benefit. Such a testamentary trust will provide for the retarded person while avoiding an outright transfer to the beneficiary. The trust also affords the testator an opportunity to choose the person (i.e. the trustee) who will manage the trust property on behalf of the retarded person.

Special Considerations for Parents of a Retarded Child

Drafting a will for a parent of a retarded child requires coordination of the parent's personal objectives for the child with his financial objectives

for his estate. The age of the retarded child and the degree of independence and self-reliance that he has or may be expected to achieve will determine the manner in which property should be left to him. The size of the parent's estate, the number of other children or other persons to whom property will be left, estate tax considerations, and the amount of any government benefits received by the retarded child are considerations affecting the amount of property to be set aside for the benefit of the retarded child.

In many situations, the parent should name a testamentary guardian for the child in the event the child has no surviving parent. He should place any property to be held for the benefit of the child in a trust. More difficult questions, however, arise concerning the amount of property to be set aside for the child, the possible loss of certain government benefits and assistance to the child due to his inheritance of property, and the ability of a state institution providing care for the retarded child to reach the trust for reimbursement.

If a parent has a small estate, he may wish simply to leave his property to his surviving spouse, who will care for the child. In the event he has no surviving spouse, he may leave all his assets to his other children, omitting the retarded child and thereby preventing any loss of government benefits to the retarded child.

A parent having a larger estate, however, will want to secure the maximum estate tax savings possible for his estate while assuring adequate provision for the retarded child. Accordingly, the parent should be certain that his will is drafted to obtain the marital deduction for bequests to a surviving spouse.

Property to be set aside for the retarded child should be placed in a trust, providing for discretionary distributions of income or corpus to or for the benefit of the child. The specific terms of such a trust must be determined by the parent's objectives after considering a number of factors. First, property passing to a retarded child may disqualify him for certain government benefits if such property is counted as an "asset" of the child. Additionally, income from the trust paid to or for the child's benefit may constitute "unearned income," thereby reducing the amount of the child's monthly benefits from certain government assistance. Finally, a state institution, such as a retardation center, may be able to attach a portion of the trust assets as reimbursement for care and services provided to the retarded child.

A parent with substantial assets may not be concerned with these problems. He may wish simply to require the trustee to pay all amounts necessary for the proper care and support of such child; however, parents with insufficient assets, or those who simply wish to insure that the retarded child is adequately supported throughout his lifetime, should establish a trust that will supplement any benefits available to the child by means of federal or state assistance. Such a trust should clearly state the parent's objective of supplementing governmental assistance to the child and should limit access to or attachment of the trust by creditors and/or governmental providers of services and benefits and the retarded child. Distributions from such a trust should be entirely discretionary with the trustee and could be limited to expenses for needs not otherwise provided for the child through government benefits or institutional care. Additionally, the trustee should be instructed to expend government benefits to which the child is entitled prior to invading the trust to pay for the care of the child, and he should be prohibited from expending trust funds for costs of care provided by governmental entities. The retarded child should have no direct access to the trust funds and should not receive income from the trust in excess of the "unearned income" limits placed on recipients of SSI benefits.

When creating such a trust, a parent should be aware that no court in Mississippi has considered the issue of the state's right of reimbursement against such a trust for the costs of care rendered to the retarded beneficiary; however, since a parent can completely disinherit his retarded child, no public policy should be violated by the establishment of a trust which will provide additional care and services not available through government assistance.

The parent should name an appropriate trustee under the will to administer any trust created for a retarded child. Because of the special needs of the child, the appointment of co-trustees may achieve the best results. A bank or other financial institution can perform needed management and investment functions, while a family member, as co-trustee, can supervise the personal care of the child. Successor trustees may be named in the event the original trustees are unable to serve. For a small trust, designation of a family member as sole trustee may avoid certain administrative fees charged by banks and other corporate trustees. Additional administrative expense may be avoided if the parent waives bond and accounting requirements with respect to the named trustee, thereby eliminating court administration of the trust.

Two assets that may prove useful in funding a trust or providing support for a retarded child after the parent's death are life insurance proceeds payable at the death of the parent and pension benefits payable to the parent's survivors. These assets should be utilized in a manner compatible with the desired tax consequences, discussed more fully in this paper.

Trusts

A trust is perhaps the most useful and flexible estate planning tool available.

(1) What is a trust?

A trust is a fiduciary relationship in which one party, the trustee, holds the property for the benefit of another person, the beneficiary.

(2) What are the elements of a trust?

(a) Grantor-	The person who creates the trust.
(b) Trustee-	The person who holds the trust property for the beneficiary according to the provisions of the trust.
(c) Beneficiary-	The person for whose benefit the corpus is held. There are two types of beneficiaries: (1) income and (2) remainderman.
(d) Corpus or Res-	The assets that are held by the trustee for the beneficiary.
(e) Trust instrument-	The document which sets forth the rights, duties, and interests of the parties.

(3) Who can be a trustee?

Generally, any natural person or corporation that is capable of taking title to the corpus may be the trustee. Government or municipal corporations, trust companies, banks, as well as individuals may function as trustees.

The sole beneficiary of a trust, however, cannot be the sole trustee because the legal and equitable titles would then merge.

(4) Who may be a beneficiary?

Any legal entity or person that is capable of holding title to property and of being an obligee may be a beneficiary.

(5) Capacity to be a beneficiary:

Basically, a minor, insane, or retarded person has capacity to be the beneficiary of a trust. A person who has the capacity to hold title to property

may be the beneficiary. It does not matter that the beneficiary cannot transfer property or make a contract due to his or her disability.

(6) Income Beneficiary:

An income beneficiary is one who is entitled to the income that results from the trust property, i.e. interest earned. Income beneficiaries typically receive income for their life, and upon their death, the principal passes to another.

Remainderman:

A remainderman is one who is entitled to the remainder of the trust. In other words, this is a person who gets what is left over after the income beneficiaries die or their interest expires.

For instance, if A creates a trust with income to B for life and remainder to C, B is an income beneficiary and D is the remainderman.

(7) Living Trusts v. Testamentary Trusts:

A living trust is one that is created during one's lifetime. It can be either a revocable or irrevocable trust. On the other hand, a testamentary trust is created by one's will and takes effect at the grantor's death. Because of its nature, a testamentary trust is always irrevocable.

The primary significance between a living trust and a testamentary trust bears upon the creation of the trust. To create a testamentary trust, one must execute a valid will. A living trust, however, is created by a valid gift, contract, or the exercise of a general power of appointment during one's lifetime.

(8) Revocable Trusts v. Irrevocable Trusts:

The distinction between revocable and irrevocable trusts is applicable only to living trusts because testamentary trusts are always irrevocable.

Revocable Trusts:

Generally, the grantor transfers assets to the trustee but retains the power to revoke, alter, or amend the trust. He may also retain the right to the trust income during his lifetime. Upon the death of the grantor, the assets are either distributed or held in trust for another beneficiary. Because the grantor reserves the right to change the trust or to receive the income from the trust, the corpus of the trust is included in the grantor's estate for estate tax purposes.

Irrevocable Trusts:

An irrevocable trust is simply a trust that may not be revoked or changed after its creation. As long as the grantor has not retained any beneficial trusts in the trust or has not given up such an interest within three years of death, the assets should not be included in the taxable estate of the grantor. A gift tax may, however, be included on the creation of an irrevocable trust.

(9) What are the powers of a trustee?

There are several different types of powers that a trustee might have, such as:

(a) express--these are powers that are specifically stated in the trust agreement, or by court order, or by statute. Express powers generally include the power to sell the trust property, to invest the proceeds thereof, to pay income to beneficiaries and so forth.

(b) implied--includes those powers that are essential in order to fulfill the purposes of the trust.

(c) mandatory--the grantor may instruct the trustee to carry out certain administrative acts. In doing so, a power is created, and a duty to use the power is imposed upon the trustee.

(d) discretionary--a discretionary power is one in which the grantor allows the trustee to use its judgement as to whether a certain act should be performed. It should be noted that even if the trustee has discretionary powers, the use of these powers is still within the purview of the courts. The courts generally, however, will not interfere with the trustee's decisions provided that the power is exercised in good faith after considering the various factors involved. On the other hand, the courts may instruct the trustee to change or reconsider the decision if he has acted in bad faith or arbitrarily.

A typical power is the power to sell the assets. This power is either express or implied due to an inference to make the trust productive. As a natural consequence of a power to sell, the trustee is also given the power to execute contracts in relation to the sale.

Other powers of the trustee include the power to incur expenses, lease trust property, mortgage or borrow money, compromise, arbitrate, or abandon claims, and exercise the powers of stockholders, including the power to vote.

(10) Co-Trustees and their Powers:

Co-trustees exist when the grantor names two or more trustees of a private trust, and assuming he does not indicate otherwise, the powers are held jointly

by all of the trustees. Accordingly, the trustees must all concur in the exercise of their powers. The co-trustees likewise hold the trust property as joint tenants.

If one co-trustee tries to act without the others, his actions will generally be deemed void; however, the creator may allow a majority of three or more co-trustees to make decisions concerning the trust. Furthermore, the grantor may give one power to one co-trustee and a different power to another co-trustee.

Unlike the situation of a private trust, co-trustees for a charitable trust are generally not required to have unanimity in order to act for the trust. Instead, a majority of the co-trustees may make decisions for the trust.

(11) Duties of the Trustee:

The trustee must generally perform its duties with ordinary care unless stated otherwise in the trust instrument. In other words, the trustee must use the skills of an ordinary capable person. Some of the more common duties are as follows:

(a) Duty of Loyalty--This is one of the most important duties of a trustee. The duty essentially requires the trustee to administer the trust in the best interest of the beneficiary and not let a third party's interest or the trustee's own interest interfere with the administration of the trust.

(b) Duty of Administration--The trustee is under a duty to administer the trust upon his/her acceptance of the trust. This duty is required even though the trustee may not receive any compensation for his/her services.

(c) Duty to Account--Under this duty, the trustee is required to keep and render accurate accounts with respect to the financial condition of the trust. Failure to keep accurate accounts makes the trustee liable for any loss or expenses resulting from this failure. Furthermore, the trustee may be compelled by the beneficiary to produce an account of the trust to a court.

(d) Duty to Inform--Similar to the duty to account, the trustee must furnish the beneficiary complete information upon his or her request. The trustee must also permit the beneficiary or a person authorized by the beneficiary to inspect the trust property.

(e) Duty to Make Productive--This duty is either expressed or implied upon the trustee in most trusts. Normally, the duty to make productive includes determining what funds are available for investment, when investments should be made, and what should be done in leasing or managing land.

(f) Duty to Earmark--Basically the trustee has a duty to separate trust property from all other property and to earmark (label)

all trust property as such. The duty to separate seeks to prevent the trustee from co-mingling trust funds with its own. The duty to earmark essentially requires the trustee to mark bonds and notes as being held by him as trustee.

(g) Duty Not to Delegate--This duty prohibits the trustee from delegating to others those acts that he can reasonably perform. It can, however, delegate certain acts. To determine which acts may be delegated, the trustee should consider the following factors:

(1) amount of discretion involved;

(2) value and character of property involved;

(3) whether the property is principal or income;

(4) remoteness or proximity of the subject matter of the trust;

(5) if the act requires professional skills or facilities that the trustee may or may not possess.

(h) Duty of Impartiality--If there are two or more beneficiaries of a trust, the trustee must deal impartially with them. The trustee may, however, have the discretion to favor one beneficiary over the other under the trust provisions.

(12) How is a Trustee Selected?

The grantor normally selects the trustee. In order to do so, the grantor only needs to show that a trust is in existence and that someone is desired to administer it. A trust, however, will not fail merely because the grantor does not select a trustee. The court will appoint a trustee in these situations and also in those situations where the named trustee is unable to administer the trust due to incompetency, disqualification, death, or refusing to accept the trust, but the grantor may provide for a substitute trustee or give the power to others to name a trustee at the outset in the trust.

A "personal trustee" is one named by the grantor because he believes that trustee to be the only person who can administer the trust. This situation occurs primarily in family circumstances wherein the trustee is a family member. It should be noted that a substitute trustee will not be allowed if the personal trustee is unable to administer the trust.

(13) Compensation of the Trustee:

A trustee has a right to be compensated for his services unless he has agreed to serve as trustee without charge. In order for the trustee to receive compensation, it is not necessary that it be expressly provided for in the trust instrument. If the instrument fails to create a provision for compensation, the trustee will be awarded a reasonable fee for his services either in

equity or by statute. If the trust is administered by co-trustees, the total compensation due is divided among them according to the services each has performed.

A court of equity will award the trustee a reasonable fee for his services. In doing so, the court will consider the time and effort involved, special skills that the trustee used, the market rates for similar work, the success or failure of the trust, the amount of income and principal involved, the risk and responsibilities the trustee incurred, and other relevant factors.

Many states, including Mississippi, have statutes that provide for compensation to be awarded trustees. The statutes usually award compensation by establishing a fee schedule or a provision that provides that the trustee will receive reasonable compensation or such compensation as equity may determine to be fair. The rates are generally graduated so that a higher percentage is charged for smaller trusts.

It should be mentioned that a trustee may lose his right to compensation if he waives this right. Also, the court may lower or refuse the trustee his compensation if he is guilty of a serious breach of trust.

(14) What is a Discretionary Trust?

If the terms of the trust provide that the trustee shall pay to or apply for the beneficiary only so much of the trust income or principal for a certain purpose as he sees necessary, a discretionary trust exists. The remainder of the trust income or property may be used for another purpose. The name of this type of trust derives from the fact that the trustee acts in his discretion. He can give the beneficiary some benefits or nothing at all.

Another characteristic of a discretionary trust is that, prior to an election to pay or apply, a creditor or transferee of the beneficiary cannot compel the trustee to pay or apply. If there is a suit to force the trustee to pay or apply, the trustee may maintain that he has chosen not to do so. Accordingly, the beneficiary does not have an assignable interest or an interest subject to the claims of his creditors prior to the election by the trustee because of the very nature of the trust. Once the trustee makes an election, however, the beneficiary has an interest that is assignable and subject to the claims of his creditors.

It is worth noting that if the beneficiary assigns any interest or if his creditors endeavor to reach the trust before the trustee has made an election,

the trustee will subsequently be liable to the assignee or creditor for the amount he paid or applied to the beneficiary.

(15) Spendthrift Trusts:

A spendthrift trust is a trust that prevents the beneficiary from transferring his rights to future payments, and it also prevents his creditors from subjecting the beneficiary's interest to their claims. Spendthrift trusts are created in an effort to provide for the support of someone but to also withhold the corpus or income from that person's lack of thriftiness. Such a trust is not created for the purpose of preventing the beneficiary from spending the money after the trustee has given it to him or for the purpose of preventing his creditors from taking it thereafter. Instead, the purpose of these trusts is to "prevent anticipation of trust income or principal by assignments of the right to receive future income or principal or from attempts by creditors of the beneficiary to reach such right." In short, a spendthrift clause gives a beneficiary a right to future income, but he cannot assign this right or apply it as payment of his debts. Most states allow spendthrift trusts, although a few do not. In those states that allow them, some have placed statutory restrictions upon the trusts.

Mississippi has upheld spendthrift trusts for beneficiaries but not for grantors.

Life Insurance

Life insurance can be very useful in planning an estate. It may be used to guarantee that the insured's family will have sufficient assets after the insured's death for support, medical expenses, and education where they otherwise would not. Life insurance may also be used to pay the estate taxes and administration expenses of the insured's estate and to provide living expenses for the insured's family until other assets can be sold.

Types of Policies

There are three main types of life insurance: whole life, term, and endowment. A whole life policy remains in force so long as the premiums are paid. If the policy is in force at the time of the insured's death, a death benefit in the amount of the face value of the policy is paid to the beneficiary. A whole life policy also provides cash value that increases each year that the

policy is in force and is payable to the policy owner if the policy lapses. Limited pay life insurance is a form of whole life insurance that provides the same benefits as a whole life policy, but premiums are only paid for a stated period of time. Because the limited pay life policy is paid up within a specified time, the yearly premiums are greater than those for a whole life policy. Term insurance is issued for a specified period, the term, and only provides benefits at the insured's death if then in force. The premiums are generally cheaper than for a whole life policy while the insured is young but increase as the insured grows older. In an endowment insurance policy, a premium is paid for a stated period of time, but the premiums are higher than those for limited pay policies. The face amount of the policy is paid on either the expiration of the term or the prior death of the insured. Endowment policies are generally used to insure that there will be sufficient funds for education of children on the death of their parents.

Settlement Options

Besides a lump sum settlement, there are four primary ways in which the proceeds of a life insurance policy may be paid to the beneficiary after the death of the insured: the interest option, the installment option, an annuity, and special options. The beneficiary may select an option if the insured has not previously done so.

Under the interest option, the beneficiary periodically receives interest on the insurance policy proceeds that are retained by the insurance company. At a specified time, the proceeds may be withdrawn by the beneficiary.

There are two types of installment options: installments for a fixed amount and installments for a fixed period. Under a fixed amount option, the beneficiary periodically receives payments from the policy proceeds and interest until the proceeds and interest are exhausted. Under a fixed period option, the beneficiary receives payments from the policy proceeds and interest for a fixed period of time. The amount of each payment depends on the total number of payments to be made and the total amount to be distributed. Under either the fixed amount or fixed period option, the secondary beneficiary begins receiving any unpaid installments on the death of the primary beneficiary.

There are two principle types of annuity options: straight life and joint and survivor. Under a straight life annuity option, insurance policy proceeds

are used to buy an annuity that periodically pays the primary beneficiary a specified amount for life. The payments end on the death of the primary beneficiary. Each of two beneficiaries receive periodic payments until the death of the last survivor under a joint and survivor option.

Special settlement options are sometimes available. This type of insurance allows a settlement to be fashioned from a combination of options that best meet the needs of the beneficiary.

Tax Considerations

Premiums paid by a taxpayer for insurance policies on his life are not tax deductible. Proceeds of insurance policies paid on the death of the insured are not taxable to the beneficiary, but interest on the proceeds is taxable. Dividends earned by a life insurance policy are deemed to be a return of premium and therefore are not taxable as income, but the interest on dividends left with the insurance company is taxable.

Estate taxes must be paid on life insurance on a taxpayer's life over which the taxpayer retained any power. These powers are known as incidents of ownership and include such powers as the ability to change beneficiaries or to assign the policy. The amount subject to estate taxes if the taxpayer has retained any incidents of ownership over a policy is the face amount of the policy plus dividend accumulations and unearned premiums but less any loans outstanding against the policy. In order to escape estate tax liability on an insurance policy, the policy may be given away to an irrevocable insurance trust for the benefit of family members or to an individual directly, such as the named beneficiary of the policy. But gift tax liability may be incurred. Since the gift tax value is approximately equal to the cash surrender value of the policy, the gift tax liability incurred will still be less than the estate tax liability incurred if the policy is not given away. If given away within three years of death, however, the policy is still includable in the taxpayer's estate.

Practical Uses

Life insurance is an easy and inexpensive way to insure that sufficient assets are available at death to care for loved ones still alive.

Annuities

An annuity is an agreement to make payments of a specified sum at periodic intervals for either a specific term or for as long as the annuitant lives. Annuities, which are usually used to provide income for the annuitant when he or she grows old, differ from life insurance that provides benefits at the death of the insured.

Types of Annuities

Annuities fall into two broad categories: commercial and private. A commercial annuity is one that is sold by an organization such as an insurance company. A private annuity is one paid by someone who ordinarily does not sell annuities. Private annuities usually result from interfamily transfers for estate planning purposes in exchange for a promise to make periodic payments to the transferor. Private annuities will not be explained in detail since their use is restricted.

There are four principle types of commercial annuities: straight life, refund, joint life and survivorship, and life annuity with term certain. A straight life annuity provides periodic payments for the life of the annuitant. Regardless of the amount paid, the payments terminate at the death of the annuitant. For example, if A pays $12,000 for an annuity that is to pay him $100 per month but A dies six months after the payments begin, no further payments are made.

Under a refund annuity, the annuitant receives periodic payments until death. At death, the amount by which the purchase price of the annuity exceeds the total periodic payments made during life to the annuitant is refunded to the annuitant's beneficiary. For example, if A pays $12,000 for an annuity that is to pay him $100 per month but A dies 10 months after the payments begin, $11,000 will be refunded. This refund can be made by continuing the periodic payments under an installment refund annuity or by making a lump sum refund under a cash refund annuity.

A life annuity with a term certain provides the annuitant with periodic payments for life. If, however, the annuitant dies before the end of a specified term, payments are made to the annuitant's beneficiary for the remainder of the term. For example, if A owns an annuity with a guaranteed term of 100 months but dies after receiving only 50 payments, the payments will continue

to be made to A's beneficiary for the remaining 50 months of the term. If A lives for 150 months after the payments begin, the payments will continue until A's death and then cease.

A joint life and survivorship annuity provides periodic payments to two annuitants for their joint lives and continues for the survivor's life. This type of annuity is usually written on the lives of a husband and wife. Payments during the life of the survivor may be reduced depending on the annuity. For example, A and his wife, B, pay $12,000 for an annuity that is to pay them $100 per month while they both are living and $100 per month to the survivor after the death of either. This annuity could also be written so as to provide A and B with $110 per month while both are alive but only $80 per month to the survivor.

Income Taxation of Annuities

The fractional part of each annuity payment that is not taxable as income is known as the exclusion ratio. The exclusion ratio equals the total amount paid for the annuity divided by the total expected return from the annuity. If the annuity is to be paid for a specified term, the expected return equals the total number of payments to be made multiplied by the amount of each payment. For example, A pays $10,000 for an annuity that is to pay $1,000 per year for 15 years. The expected return is $15,000 (15 X $1,000) and the exclusion ratio is 10,000/15,000 or 2/3. Therefore, A does not have to pay income tax on two-thirds of each $1,000 received each year from the annuity. If the annuity is to be paid for life, the total number of payments to be received is based on the life expectancy of the annuitant as derived from the life expectancy tables of the Treasury Department. For example, A, a male, is to receive $100 per month ($1200 per year) for life from an annuity. At the time the payments are to start, A's age at his nearest birthday is 33. Under life expectancy Table I at Treas. Reg. section 1.72-9, A has a life expectancy of 40 years. His expected return from the annuity is therefore $48,000 (40 X $1200).

Gift Taxation of Annuities

The taxable value of a gift of an annuity that is purchased at the time of the gift is the cost of the annuity. If the annuity is given away at a date considerably later than the date of purchase, the gift tax value is the amount

that would be charged for a single premium annuity providing the same annual payment for the life of a person of the donor's age. For example, A purchases an annuity from company X and is to receive $1,000 per year for life from the annuity. When A is 40 years old and after receiving annuity payments for five years, A gives the annuity away. The gift tax value is the amount that company X would charge a 40-year-old male for an annuity that will pay the purchaser $1,000 per year for life.

Estate Taxation of Annuities

The present value of an annuity at the date of death will be includable in a taxpayer's estate if the taxpayer had a right to the annuity or was in fact receiving payments from the annuity during life. The present value of an annuity is the value at the taxpayer's death of the payments from the annuity that are payable to the taxpayer's beneficiary. The Treasury Department has prepared tables that give the present value of both life and term-of-years annuities. For example, A owns an annuity that is to pay A $10,000 per year for the life of his brother, B. A dies when B is 52 years 8 months old and after A has received a payment. Under Table A (1) of section 20.2031-10 of the Treasury Regulations, 10.7200 is the figure in column 2 that is opposite 53, the number nearest B's actual age. The present value of the annuity at the date of A's death is therefore $107,200 ($10,000 X 10.7200). If, however, A's annuity is to pay $10,000 per year for 10 years and A dies after having received the fifth payment, A's beneficiary would be entitled to receive five more payments. Under Table B of section 20.2031-10 of the Treasury Regulations, the figure in column 2 opposite five years is 4.2124. The present value of the annuity is therefore $42,124 ($10,000 X 4.2124). New proposed regulations have been released by the Treasury Department that would affect these figures for decedents dying after November 30, 1983.

Annuities Under Qualified Retirement Plans

Certain types of plans, known as qualified retirement plans, provide annuities that are specifically excluded from the estate of the owner of the plan but cannot be given away. Such an annuity is not subject to estate taxes even though paid to the owner's spouse or children after the owner's death. Additionally, the earnings derived from investing the contributions to a qualified plan are not taxable as income until the earnings are actually withdrawn from the plan.

There are four primary types of qualified retirement plans: (1) defined contribution, (2) defined benefit, (3) HR-10 or Keogh, and (4) individual retirement account (IRA). Defined contribution and defined benefit retirement plans are the principle types of qualified corporate retirement plans. In a defined contribution plan, a maximum of 25 percent of each participating employee's income is contributed to the plan(s) by the company and invested. The maximum contribution per year for each employee cannot exceed $30,000. The amount in the employee's account at the time of the employee's retirement is used to buy an annuity for the employee or to make periodic or lump-sum payments to the employee. A defined benefit plan guarantees the participating employee a specified amount of pension on retirement. The maximum pension is limited to $90,000. The employer periodically contributes the amount necessary to provide the promised pension. Under both types of corporate pension plans, the company's contribution to the plan is tax deductible to the company but not taxable as income to the employee when made. While the annuity cannot be given away, a beneficiary of the payments made after the employee's death can be named without incurring gift tax liability.

The proceeds from a qualified corporate plan may be taken in a lump sum or in periodic installments. If taken in periodic payments and only the employer has contributed to the plan, each payment is taxable as ordinary income when received by the employee. If both the employer and employee have contributed to the plan, the periodic distributions are treated as an annuity for income tax purposes. The cost of the annuity is the amount contributed by the employee. For example, both A, a male aged 65 at retirement, and A's employer contribute to a plan for A's benefit. A contributes $5,000 and is to receive $1,000 per year for life. Under life expectancy Table I at section 1.72-9 of the Treasury Regulations, A has a life expectancy of 15 years. His expected return from the annuity is $15,000 ($1,000 X 15) and the exclusion ratio is $5,000/$15,000 or 1/3. Therefore, A does not have to pay income tax on one-third of each $1,000 annual payment from the annuity. If, however, the employee will recover his contribution to the plan within three years from the time the annuity payments begin, the payments are not taxable to the employee until his full contribution is recovered. Subsequent payments are then fully taxable as ordinary income; therefore, if A in the previous example contributes $5,000 to the plan but is to receive $2,000 per year from the annuity, A would recover his $5,000

investment within three years. A pays no tax on the first two yearly payments and no tax on the first $1,000 received the third year. Since A has now recovered his $5,000 investment, the second $1,000 of the third yearly payment and all subsequent payments are taxable as ordinary income to A.

If the proceeds of the annuity are taken in a lump sum, the employee may be entitled to treat part of the proceeds attributable to the employer's contribution as long-term capital gain with the remainder treated as ordinary income. An accountant or tax attorney should be consulted before making a withdrawal due to the complexity of the laws concerning lump sum payments from qualified retirement plans.

Keogh and individual retirement accounts are the principle types of qualified individual retirement plans. Any self-employed person can now contribute up to 25 percent of his annual income, not to exceed $30,000, to a Keogh plan. For example, if A is self-employed and earns $10,000 in 1984, A can contribute up to $2,500 (25 percent of $10,000) in 1984 to a Keogh plan. If, however, A earns $400,000 in 1984, the maximum of $30,000 can be contributed to a Keogh plan. If $15,000 is contributed each year for 25 years to a Keogh plan that earns eight percent interest, the account will contain $1,096,500 at the end of the 25-year period. If the plan continues to earn eight percent interest, over $100,000 per year can be withdrawn in retirement benefits for 25 years before the funds will be exhausted.

For tax years beginning after 1981, an individual whether or not an active participant in a qualified employer plan or in a government plan, may take an income tax deduction for his or her cash contributions to an IRA account each year to the extent of the smaller of the following amounts (a) $2,000 or (b) 100 percent of an individual's annual earned compensation. If A earns $50,000, in 1984, even if he is a participant in an employer qualified plan, $2,000 can be contributed to an IRA. If the maximum $2,000 contribution is made every year to an IRA that earns eight percent interest, the account will contain $146,200 at the end of 25 years. If the account continues to earn eight percent interest, over $13,000 per year can be withdrawn for 25 years before the funds will be exhausted.

Under both types of individual plans, there is 100 percent vesting immediately, but the proceeds must begin to be withdrawn when the owner is between the ages of 59½ and 70½ unless the owner is disabled or dies prior to

reaching age 59½. Furthermore, both plans allow the naming of a beneficiary to receive the proceeds of the plan at the employee's death. All amounts distributed from an IRA are taxable to the recipient in the year received as ordinary income with no part being eligible for capital gain treatment. A portion of the proceeds from a Keogh plan may, however, be entitled to capital gain treatment in the same manner as the proceeds from corporate plans.

The owner of a qualified retirement plan can name a trust as the beneficiary of the proceeds of the plan. A child of the plan's owner can, in turn, be designated as the beneficiary of the trust. By designating a trust as the beneficiary of the retirement plan, probate is avoided and an orderly manner for distributing the trust assets for the child's benefits can be stipulated in the trust instrument. Furthermore, the benefits from the qualified plan will not be includable in the employee's estate up to a maximum exclusion of $100,000.

Conclusion

In summary, the author hopes this slight introduction to the laws of estate and gift taxation, wills, trusts, life insurance and annuities will serve as a springboard to effectively plan your own estate. Each person is different and each person's estate plan is consequently a little different too; however, with careful planning and with the help of competent professional advice, one can accumulate an estate during life and leave that estate for the benefit of his or her loved ones. In doing so, you will be planning a more secure future for your severely handicapped child as well as your other family members.